

ADVANTAGE TECHNOLOGIES GROUP INC

Form 10-Q

August 10, 2010

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED June 30, 2010

OR

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

Commission File number 1-10799

ADDvantage Technologies Group, Inc.  
(Exact name of registrant as specified in its charter)

OKLAHOMA 73-1351610  
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification No.)  
organization)

1221 E. Houston  
Broken Arrow, Oklahoma 74012  
(Address of principal executive office)  
(918) 251-9121  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐ Accelerated  
filer ☐

Non-accelerated filer ☐ (do not check if a smaller reporting  
company) Smaller reporting company ☒

Indicate by check mark whether the registrant is a shell company (as  
defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Shares outstanding of the issuer's \$0.01 par value common stock as of  
July 30, 2010 were  
10,143,970.

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ADVANTAGE TECHNOLOGIES GROUP, INC.  
Form 10-Q  
For the Period Ended June 30, 2010

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ADVANTAGE TECHNOLOGIES GROUP, INC.  
CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (unaudited)	September 30, 2009 (audited)
Assets		
Current assets:		
Cash and cash equivalents	\$6,331,591	\$700,004
Accounts receivable, net of allowance of \$300,000	5,158,617	4,199,136
Income tax refund receivable	20,516	88,411
Inventories, net of allowance for excess and obsolete inventory of \$2,507,000 and \$2,196,000, respectively	28,546,018	33,166,624
Deferred income taxes	1,442,000	1,282,000
Prepaid expenses	92,340	107,423
Total current assets	41,591,082	39,543,598
Property and equipment, at cost:		
Land and buildings	7,208,679	7,188,936
Machinery and equipment	3,252,234	3,258,819
Leasehold improvements	205,797	205,797
	10,666,710	10,653,552
Less accumulated depreciation and amortization	(3,361,372 )	(3,096,885 )
Net property and equipment	7,305,338	7,556,667
Other assets:		
Deferred income taxes	663,000	744,000
Goodwill	1,560,183	1,560,183
Other assets	23,809	28,098
Total other assets	2,246,992	2,332,281
Total assets	\$51,143,412	\$49,432,546

See notes to unaudited consolidated financial statements.

ADVANTAGE TECHNOLOGIES GROUP, INC.  
CONSOLIDATED BALANCE SHEETS

	June 30, 2010 (unaudited)	September 30, 2009 (audited)
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	\$2,177,618	\$2,523,143
Accrued expenses	1,236,882	1,095,822
Notes payable – current portion	1,814,008	1,863,767
Total current liabilities	5,228,508	5,482,732
Notes payable	12,511,630	13,992,873
Other liabilities	1,150,442	1,049,685
<b>Shareholders' equity:</b>		
Common stock, \$.01 par value; 30,000,000 shares authorized; 10,367,934 and 10,340,784 shares issued, respectively;		
10,143,970 and 10,116,820 shares outstanding, respectively	103,679	103,408
Paid in capital	(6,076,186 )	(6,151,530 )
Retained earnings	39,345,060	36,007,342
Accumulated other comprehensive income (loss):		
Unrealized loss on interest rate swap, net of tax	(713,442 )	(645,685 )
	32,659,111	29,313,535
Less: Treasury stock, 223,964 shares, at cost	(406,279 )	(406,279 )
Total shareholders' equity	32,252,832	28,907,256
Total liabilities and shareholders' equity	\$51,143,412	\$49,432,546

See notes to unaudited consolidated financial statements.



ADVANTAGE TECHNOLOGIES GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME  
(UNAUDITED)

	Three Months Ended June 30, 2010		Nine Months Ended June 30, 2010	
	2009		2009	
Sales:				
Net new sales income	\$9,386,857	\$5,980,946	\$23,749,544	\$20,868,217
Net refurbished sales income	2,492,755	1,800,146	7,613,522	7,213,255
Net service income	1,417,837	1,367,815	4,209,125	3,994,077
Total net sales	13,297,449	9,148,907	35,572,191	32,075,549
Cost of sales	9,089,475	6,173,942	24,414,081	22,192,806
Gross profit	4,207,974	2,974,965	11,158,110	9,882,743
Operating, selling, general and administrative expenses	1,758,724	1,704,671	5,164,803	5,472,703
Income from operations	2,449,250	1,270,294	5,993,307	4,410,040
Interest expense	197,016	223,688	609,589	717,929
Income before provision for income taxes	2,252,234	1,046,606	5,383,718	3,692,111
Provision for income taxes	856,000	392,000	2,046,000	1,385,000
Net income attributable to common shareholders	1,396,234	654,606	3,337,718	2,307,111
Other comprehensive income:				
Unrealized gain (loss) on interest rate swap, net of taxes	(113,419 )	264,476	(67,757 )	(396,947 )
Comprehensive income	\$1,282,815	\$919,082	\$3,269,961	\$1,910,164
Earnings per share:				
Basic	\$0.14	\$0.06	\$0.33	\$0.23
Diluted	\$0.14	\$0.06	\$0.33	\$0.23
Shares used in per share calculation:				
Basic	10,143,970	10,158,185	10,128,887	10,169,987
Diluted	10,148,303	10,160,040	10,132,548	10,171,878

See notes to unaudited consolidated financial statements.

ADVANTAGE TECHNOLOGIES GROUP, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Nine Months Ended June 30,	
	2010	2009
<b>Operating Activities</b>		
Net income	\$3,337,718	\$2,307,111
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	297,705	305,098
Provision for losses on accounts receivable	25,477	138,000
Provision for excess and obsolete inventories	603,806	715,000
Loss on disposal of property and equipment	13,854	—
Deferred income tax benefit	(46,000 )	(46,000 )
Share based compensation expense	64,784	91,532
Changes in assets and liabilities:		
Accounts receivable	(984,958 )	3,139,320
Income tax refund receivable	67,895	(21,796 )
Inventories	4,016,800	(867,585 )
Prepaid expenses	15,083	(6,471 )
Other assets	15,120	18,370
Accounts payable	(345,525 )	(1,755,971)
Accrued expenses	141,060	(5,399 )
Net cash provided by operating activities	7,222,819	4,011,209
<b>Investing Activities</b>		
Additions to machinery and equipment	(57,087 )	(31,366 )
Disposals of machinery and equipment	16,600	28,000
Additions of land and buildings	(19,743 )	(7,793 )
Net cash used in investing activities	(60,230 )	(11,159 )
<b>Financing Activities</b>		
Net change in bank revolving line of credit	—	(2,304,978)
Payments on notes payable	(1,531,002)	(1,397,826)
Purchase of treasury stock	—	(279,314 )
Net cash used in financing activities	(1,531,002)	(3,982,118)
Net increase in cash and cash equivalents	5,631,587	17,932
Cash and cash equivalents at beginning of period	700,004	15,211
Cash and cash equivalents at end of period	\$6,331,591	\$33,143
<b>Supplemental cash flow information:</b>		
Cash paid for interest	\$616,219	\$725,143
Cash paid for income taxes	\$2,058,180	\$1,497,465
<b>Supplemental schedule of noncash operating activities:</b>		
Unrealized loss on interest rate swap	\$(100,757 )	\$(650,947 )

Deferred tax benefit	33,000	254,000
Unrealized loss on interest rate swap, net of tax	\$(67,757 )	\$(396,947 )

See notes to unaudited consolidated financial statements.

Note 1 - Basis of Presentation and Description of Business

Basis of presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial statements and do not include all the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. However, the information furnished reflects all adjustments, consisting only of normal recurring items which are, in the opinion of management, necessary in order to make the financial statements not misleading. The consolidated financial statements as of September 30, 2009 have been audited by an independent registered public accounting firm. It is suggested that these consolidated financial statements be read in conjunction with the financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2009.

Description of business

ADDvantage Technologies Group, Inc., through its subsidiaries Tulsat Corporation, Tulsat-Atlanta LLC, ADDvantage Technologies Group of Nebraska (dba "Tulsat-Nebraska"), ADDvantage Technologies Group of Texas (dba "Tulsat Texas"), Jones Broadband International, Inc. (dba "Tulsat-West"), NCS Industries, Inc., ADDvantage Technologies Group of Missouri, Inc. (dba "ComTech Services") and Tulsat-Pennsylvania LLC (dba "Broadband Remarketing International") (collectively, the "Company"), sells new, surplus and refurbished cable television equipment throughout North America, Central America, South America and, to a substantially lesser extent, other international regions that utilize the same technology. In addition, the Company also repairs cable television equipment for various cable companies. The Company operates in one business segment and product sales consist of different types of equipment used in the cable television equipment industry.

Fair value of financial instruments

The carrying amount of cash and cash equivalents approximates fair value due to the short-term maturity of these instruments. The carrying amounts of accounts receivable and accounts payable approximate fair value due to their short maturities.

Note 2 – Earnings Per Share

Basic earnings per share are based on the sum of the average number of common shares outstanding and issuable restricted and deferred shares. Diluted earnings per share include any dilutive effect of stock options and restricted stock. In computing the diluted weighted average shares, the average stock price for the period is used in determining the number of shares assumed to be reacquired under the treasury stock method from the exercise of options.

Basic and diluted earnings per share for the three and nine months ended June 30, 2010 and 2009 are:

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2010	2009	2010	2009
Net income attributable to common shareholders	\$1,396,234	\$654,606	\$3,337,718	\$2,307,111
Basic weighted average shares	10,143,970	10,158,185	10,128,887	10,169,987
Effect of dilutive securities:				
Stock options	4,333	1,855	3,661	1,891
Diluted weighted average shares	10,148,303	10,160,040	10,132,548	10,171,878
Earnings per common share:				
Basic	\$0.14	\$0.06	\$0.33	\$0.23
Diluted	\$0.14	\$0.06	\$0.33	\$0.23

### Note 3 – Line of Credit and Notes Payable

#### Line of Credit

The Company has a \$7.0 million Revolving Line of Credit (“Line of Credit”) under the Revolving Credit and Term Loan Agreement with its primary financial lender. At June 30, 2010, the Company had no amount outstanding under the Line of Credit. The Line of Credit requires quarterly interest payments based on the prevailing 30-day LIBOR rate plus 1.4% (1.75% at June 30, 2010), and the interest rate is reset monthly. The outstanding balance on the revolving credit facility is due on November 30, 2010. Borrowings under the Line of Credit are limited to the lesser of \$7.0 million or the net balance of 80% of qualified accounts receivable plus 50% of qualified inventory less any outstanding term note balances. Under these limitations, the Company’s total Line of Credit borrowing base was \$6.9 million at June 30, 2010. Among other financial covenants, the Line of Credit agreement provides that the Company must maintain a fixed charge ratio of coverage (EBITDA to total fixed charges) of not less than 1.25 to 1.0, determined quarterly. The Line of Credit is collateralized by inventory, accounts receivable, equipment and fixtures and general intangibles.

#### Notes Payable

The Revolving Credit and Term Loan Agreement includes two separate term loans, which are also collateralized by inventory, accounts receivable, equipment and fixtures and general intangibles. The first term loan is a \$2.8 million term loan. The outstanding balance under this term loan was \$2.1 million at June 30, 2010 and is due on November 20, 2021, with monthly principal payments of \$15,334 plus accrued interest. The interest rate is the prevailing 30-day LIBOR rate plus 1.4% (1.75% at June 30, 2010) and is reset monthly.

The second term loan under the Revolving Credit and Term Loan Agreement is a \$16.3 million term loan. The outstanding balance of this term loan was \$12.2 million at June 30, 2010 and is due November 30, 2012, with quarterly payments of approximately \$0.4 million plus accrued interest. The interest rate is the prevailing 30-day LIBOR rate plus 1.4% (1.75% at June 30, 2010) and is reset monthly.

The Company’s other note payable, secured by real estate, was paid off in June 2010. The interest rate was prime minus 0.25%.

The carrying value of the Company's borrowings approximates fair value since the interest rate fluctuates periodically based on a floating interest rate.

## Note 4 – Derivative Financial Instruments

The Company has an interest rate swap agreement to effectively fix the interest rate on the \$16.3 million term loan at 5.92%. The notional value of the interest rate swap amortizes quarterly with payments that mirror the \$16.3 million term loan. The Company has designated this derivative as a cash flow hedge by documenting the Company's risk management objective and strategy for undertaking the hedge along with methods for assessing the swap's effectiveness in accordance with FASB ASC 815, Derivatives and Hedging. The following table presents certain information regarding our interest rate swap:

	Amount of Loss Recognized in OCI on Derivative, Net of Tax	Amount of Loss Recognized in Accumulated OCI, Net of Tax
	Nine Months Ended June 30, 2010	September 30, 2009
Interest rate swap agreement	\$(67,757 ) \$(396,947 )	\$(713,442 ) \$(645,685 )

At June 30, 2010, the notional value of the swap was \$12.2 million and the fair value of the interest rate swap was approximately \$1.2 million, which is reflected in other noncurrent liabilities on the Company's Consolidated Balance Sheet.

FASB ASC 820, Fair Value Measurements and Disclosures, defines fair value, establishes a consistent framework for measuring fair value and establishes a fair value hierarchy based on the observability of inputs used to measure fair value. The three levels of the fair value hierarchy are as follows:

- Level 1 – Quoted prices for identical assets in active markets or liabilities that we have the ability to access. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Inputs are other than quoted prices in active markets included in Level 1 that are either directly or indirectly observable. These inputs are either directly observable in the marketplace or indirectly observable through corroboration with market data for substantially the full contractual term of the asset or liability being measured.
- Level 3 – Inputs that are not observable for which there is little, if any, market activity for the asset or liability being measured. These inputs reflect management's best estimate of the assumptions market participants would use in determining fair value.

Our interest rate swap is an over-the-counter instrument and is classified in the Level 2 hierarchy as the fair value can be estimated from executed transactions or broker quotes corroborated by other market data. These broker quotes are based on observable market prices at which similar transactions could currently be executed.

## Note 5 – Restricted Stock

## Restricted Stock

The Company granted restricted stock in March 2010 to its Board of Directors totaling 27,150 shares, which were recorded at fair value on the date of grant. The shares are being held by the Company for 12 months and will be



delivered to the directors at the end of the 12 month holding period. The fair value of these shares upon issuance totaled \$60,000 and is being amortized over the 12 month holding period as compensation expense. The unamortized portion of the restricted stock is included in prepaid expenses on the Company's Consolidated Balance Sheet.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Special Note on Forward-Looking Statements

Certain statements in Management's Discussion and Analysis ("MD&A"), other than purely historical information, including estimates, projections, statements relating to our business plans, objectives and expected operating results, and the assumptions upon which those statements are based, are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward-looking statements generally are identified by the words "estimates," "projects," "believes," "plans," "intends," "will likely result," and similar expressions. Forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties which may cause actual results to differ materially from the forward-looking statements. These statements are subject to a number of risks, uncertainties and developments beyond our control or foresight, including changes in the trends of the cable television industry, changes in our supplier agreements, technological developments, changes in the economic environment generally, the growth or formation of competitors, changes in governmental regulation or taxation, changes in our personnel and other such factors. Our actual results, performance or achievements may differ significantly from the results, performance or achievement expressed or implied in the forward-looking statements. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

### Overview

The following MD&A is intended to help the reader understand our results of operations, financial condition, and cash flows. MD&A is provided as a supplement to, and should be read in conjunction with, our financial statements and the accompanying notes to the financial statements ("Notes").

We have established ourselves, through our subsidiaries' long relationships with original equipment manufacturers ("OEM"), as distributors and/or value-added resellers of these OEM products. Tulsat is a Master Stocking Distributor for certain current and legacy products offered by Cisco within their Service Provider Video Technology Group ("SPVTG") and distributes most of Cisco's other SPVTG products. NCS Industries is a leading distributor of Motorola broadband products and is also a Master Distributor for the United States distribution of Fujitsu Frontech North America encoders, decoders and media solutions products. Our subsidiaries also distribute products from other OEMs including Standard, Blonder-Tongue, RL Drake, Corning-Gilbert, Promax, Quintech and Alpha. We also specialize in the sale of surplus new and refurbished previously-owned CATV equipment to CATV operators and other broadband communication companies. It is through our development of these vendor relationships that we have focused our initiative to market our products and services to the larger cable multiple system operators ("MSOs") and telecommunication companies. These customers provide an array of different communications services as well as compete in their ability to offer subscribers "triple play" transmission services including data, voice and video.

We also operate technical service centers specializing in Cisco-SPVTG, Motorola, Magnavox and power supply repairs.

### Recent Business Developments

Under the terms of our current agreement with Cisco, Tulsat is authorized to inventory, distribute and resell the entire line of Cisco-SPVTG current and legacy equipment and also continues to be the exclusive distributor for select Cisco-SPVTG headend and transmission products for United States customers. This agreement was set to expire January 15, 2010 and has been extended to September 30, 2010. We are currently in negotiations with Cisco

regarding this agreement as Cisco is working on modifying its SPVTG distribution model in order to align it more closely with other Cisco lines of business. Any material change in the terms or structure of our current relationship with Cisco could negatively affect our marketing of Cisco-SPVTG products or the profit margins we have historically realized on these products under the current agreement.

In March 2010, NCS Industries became a Master Distributor for the United States distribution of Fujitsu Frontech North America encoders, decoders and media solutions products as well as a member of the Fujitsu global channel partner program servicing the United States.

## Results of Operations

### Comparison of Results of Operations for the Three Months Ended June 30, 2010 and June 30, 2009

**Total Net Sales.** Total net sales increased \$4.1 million, or 45%, to \$13.3 million for the three months ended June 30, 2010 from \$9.1 million for the three months ended June 30, 2009. The overall increase was due primarily to a \$4.1 million increase in sales of new and refurbished equipment resulting from an increase in demand for headend equipment needed to add channels to our customers' cable systems or upgrade their equipment in order to provide HD programming on their cable systems, an overall equipment supply shortage in the market, which we met utilizing our On Hand On Demand business model, and an increase in sales to Latin American and Canadian customers either directly or indirectly via our alliance partners. However, our large and small domestic MSO customers continued to delay significant plant expansions and bandwidth upgrades as part of their continued efforts to conserve cash and limit capital expenditures. Sales of new equipment increased \$3.4 million, or 57%, to \$9.4 million for the three months ended June 30, 2010 from \$6.0 million for the three months ended June 30, 2009. Net refurbished equipment sales increased \$0.7 million, or 39%, to \$2.5 million for the three months ended June 30, 2010 from \$1.8 million for the same period last year. In addition to the factors discussed above, net refurbished equipment sales were also impacted by a \$0.2 million increase in sales of converter boxes for the three months ended June 30, 2010 as compared to the same period last year. Net repair service revenues remained flat at \$1.4 million for the three months ended June 30, 2010 and 2009.

**Cost of Sales.** Cost of sales includes (i) the costs of new and refurbished equipment, on a weighted average cost basis, sold during the period, (ii) the equipment costs used in repairs, (iii) the related transportation costs, and (iv) the labor and overhead costs directly related to these sales. Cost of sales increased \$2.9 million, or 47%, to \$9.1 million for the three months ended June 30, 2010 from \$6.2 million for the three months ended June 30, 2009. The increase in cost of sales was primarily attributable to the overall increase in net sales for the period. Cost of sales as a percent of revenue was 68% and 67% for the three months ended June 30, 2010 and 2009, respectively.

**Gross Profit.** Gross profit increased \$1.2 million, or 41%, to \$4.2 million for the three months ended June 30, 2010 from \$3.0 million for the three months ended June 30, 2009. The increase in gross profit was primarily attributable to the overall increase in net sales. Gross profit margin was 32% for the three months ended June 30, 2010 and 33% for the three months ended June 30, 2009.

**Operating, Selling, General and Administrative Expenses.** Operating, selling, general and administrative expenses include all personnel costs, which include fringe benefits, insurance and business taxes, as well as occupancy, communication and professional services, among other less significant cost categories. Operating, selling, general and administrative expenses increased \$0.1 million, or 3%, to \$1.8 million for the three months ended June 30, 2010 from \$1.7 million for the three months ended June 30, 2009.

**Income from Operations.** Income from operations increased \$1.2 million, or 93%, to \$2.4 million for the three months ended June 30, 2010 from \$1.3 million for the three months ended June 30, 2009.

**Interest Expense.** Interest expense was \$0.2 million for both the three months ended June 30, 2010 and 2009.

**Income Taxes.** The provision for income taxes for the three months ended June 30, 2010 was \$0.9 million, or an effective rate of 38.0%, compared to \$0.4 million, or an effective rate of 37.5%, for the three months ended June 30, 2009.

### Comparison of Results of Operations for the Nine Months Ended June 30, 2010 and June 30, 2009

**Total Net Sales.** Total net sales increased \$3.5 million, or 11%, to \$35.6 million for the nine months ended June 30, 2010 from \$32.1 million for the nine months ended June 30, 2009. The overall increase was due primarily to a \$3.3 million increase in sales of new and refurbished equipment resulting from an increase in demand for headend equipment needed to add channels to our customers' cable systems or upgrade their equipment in order to provide HD programming on their cable systems, an overall equipment supply shortage in the market, which we met utilizing our On Hand On Demand business model, and an increase in sales to Latin American and Canadian customers either directly or indirectly via our alliance partners. However, our large and small domestic MSO customers continued to delay significant plant expansions and bandwidth upgrades as part of their continued efforts

to conserve cash and limit capital expenditures. Sales of new equipment increased \$2.9 million, or 14%, to \$23.7 million for the nine months ended June 30, 2010 from \$20.9 million for the nine months ended June 30, 2009. Net refurbished equipment sales increased \$0.4 million, or 6%, to \$7.6 million for the nine months ended June 30, 2010 from \$7.2 million for the same period last year. In addition to the factors discussed above, net refurbished equipment sales were also impacted by a \$0.8 million increase in sales of converter boxes for the nine months ended June 30, 2010 as compared to the same period last year. Net repair service revenues increased \$0.2 million, or 5%, to \$4.2 million for the nine months ended June 30, 2010 from \$4.0 million for the same period last year. The repair revenue increase for the nine months ended June 30, 2010 was primarily due to our efforts to promote and expand our repair business, largely offset by our customers conserving cash by limiting the authorization for equipment repairs due to the downturn in the economy.

**Cost of Sales.** Cost of sales includes (i) the costs of new and refurbished equipment, on a weighted average cost basis, sold during the period, (ii) the equipment costs used in repairs, (iii) the related transportation costs, and (iv) the labor and overhead costs directly related to these sales. Cost of sales increased \$2.2 million, or 10%, to \$24.4 million for the nine months ended June 30, 2010 from \$22.2 million for the nine months ended June 30, 2009. The decrease in cost of sales was primarily attributable to the overall decrease in net sales for the period. Cost of sales as a percent of revenue was 69% for both the nine months ended June 30, 2010 and 2009.

**Gross Profit.** Gross profit increased \$1.3 million, or 13%, to \$11.2 million for the nine months ended June 30, 2010 from \$9.9 million for the nine months ended June 30, 2009. The increase in gross profit was primarily attributable to the overall increase in net sales. Gross profit margin was 31% for both the nine months ended June 30, 2010 and 2009.

**Operating, Selling, General and Administrative Expenses.** Operating, selling, general and administrative expenses include all personnel costs, which include fringe benefits, insurance and business taxes, as well as occupancy, communication and professional services, among other less significant cost categories. Operating, selling, general and administrative expenses decreased \$0.3 million, or 6%, to \$5.2 million for the nine months ended June 30, 2010 compared to \$5.5 million for the nine months ended June 30, 2009. The decrease was due primarily to a decrease in personnel costs of \$0.1 million, resulting from headcount reductions taken in fiscal year 2009, and a \$0.1 million reduction in bad debt expense for the nine months ended June 30, 2010 as compared to the same period last year.

**Income from Operations.** Income from operations increased \$1.6 million, or 36%, to \$6.0 million for the nine months ended June 30, 2010 from \$4.4 million for the nine months ended June 30, 2009.

**Interest Expense.** Interest expense was \$0.6 million for the nine months ended June 30, 2010 and \$0.7 million for the nine months ended June 30, 2009. The decline in interest expense was due primarily to reduced borrowing levels under our \$16.3 million term loan and Line of Credit for the nine months ended June 30, 2010 as compared to the same period last year and lower interest rates for the \$2.8 million term loan and Line of Credit for the nine months ended June 30, 2010 as compared to the nine months ended June 30, 2009.

**Income Taxes.** The provision for income taxes for the nine months ended June 30, 2010 was \$2.0 million, or an effective rate of 38.0%, compared to \$1.4 million, or an effective rate of 37.5%, for the nine months ended June 30, 2009.

#### Critical Accounting Policies

Note 1 to the Consolidated Financial Statements in Form 10-K for fiscal 2009 includes a summary of the significant accounting policies or methods used in the preparation of our Consolidated Financial Statements. Some of those significant accounting policies or methods require us to make estimates and assumptions that affect the amounts reported by us. We believe the following items require the most significant judgments and often involve complex

estimates.

#### General

The preparation of financial statements in conformity with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We base our estimates and judgments on historical experience, current

market conditions, and various other factors we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. The most significant estimates and assumptions relate to the carrying value of our inventory and, to a lesser extent, the adequacy of our allowance for doubtful accounts.

#### Inventory Valuation

Our position in the industry requires us to carry large inventory quantities relative to annual sales, but it also allows us to realize high overall gross profit margins on our sales. We market our products primarily to MSOs and other users of cable television equipment who are seeking products for which manufacturers have discontinued production or cannot ship new equipment on a same-day basis. Carrying these large inventory quantities represents our largest risk.

Our inventory consists of new and used electronic components for the cable television industry. Inventory cost is stated at the lower of cost or market, and our cost is determined using the weighted-average method. At June 30, 2010, we had total inventory of approximately \$31.0 million, against which we have a reserve of \$2.5 million for excess and obsolete inventory, leaving us a net inventory of \$28.5 million.

We are required to make judgments as to future demand requirements from our customers. We regularly review the value of our inventory in detail with consideration given to rapidly changing technology, which can significantly affect future customer demand. For individual inventory items, we may carry inventory quantities that are excessive relative to market potential, or we may not be able to recover our acquisition costs for sales that we do make. In order to address the risks associated with our investment in inventory, we review inventory quantities on hand and reduce the carrying value when the loss of usefulness of an item or other factors, such as obsolete and excess inventories, indicate that cost will not be recovered when an item is sold. For the nine months ended June 30, 2010, we recorded charges to our reserve for excess and obsolete inventory of \$0.6 million. If actual market conditions are less favorable than those projected by management, and our estimates prove to be inaccurate, we could be required to increase our inventory reserve and our gross margins could be adversely affected.

#### Accounts Receivable Valuation

Management judgments and estimates are made in connection with establishing the allowance for returns and doubtful accounts. Specifically, we analyze historical return volumes, the aging of accounts receivable balances, historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in our customer payment terms. Significant changes in customer concentration or payment terms, deterioration of customer creditworthiness, or weakening in economic trends could have a significant impact on the collectability of receivables and our operating results. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. At June 30, 2010, accounts receivable, net of allowance for returns and doubtful accounts of approximately \$0.3 million, amounted to \$5.2 million.

#### Liquidity and Capital Resources

We finance our operations primarily through internally generated funds, and we also have a bank line of credit of \$7.0 million. During the nine months ended June 30, 2010, we generated approximately \$7.2 million of cash flow from operations. The cash flow from operations was impacted by a \$1.0 million net increase in our accounts receivable. Our trade receivables increased from fiscal year end 2009 due primarily to increased revenues in the third fiscal quarter 2010. We have not experienced a significant deterioration in collections on accounts receivables, so we have kept our reserve for doubtful accounts at the same level as fiscal year end 2009. The cash flow from operations



was also impacted by a \$4.3 million net decrease in inventory. Our inventory decreased from fiscal year end 2009 due primarily to management's continuing efforts to reduce our overall inventory levels. The cash flow from operations was impacted by a \$0.3 million decrease in our accounts payable. Our accounts payable decreased from fiscal year end 2009 due primarily to timing of inventory purchases that were made at the end of the third fiscal quarter 2010.

We expect that our cash and cash equivalents of \$6.3 million as of June 30, 2010 will be sufficient for our working capital needs and scheduled debt payments in the near-term. The \$7.0 million line of credit can also be used to finance our working capital requirements. The lesser of \$7.0 million or the total of 80% of the qualified accounts receivable, plus 50% of qualified inventory, less the outstanding balances under the term loans identified in the credit agreement, is available to us under the revolving credit facility (\$6.9 million at June 30, 2010). The entire outstanding balance on the revolving credit facility is due on November 30, 2010.

During the nine months ended June 30, 2010, we made principal payments totaling \$1.5 million primarily on our two term loans under our Revolving Credit and Term Loan Agreement with our primary lender. The \$16.3 million term loan is payable over a five year period through November 2012 with quarterly payments of \$0.4 million plus accrued interest. In connection with this term loan, we entered into an interest rate swap to effectively fix the interest rate on this term loan at 5.92%. The notional value of the interest rate swap amortizes quarterly with payments that mirror the \$16.3 million term loan. The \$2.8 million term loan requires monthly payments of \$15,334 plus accrued interest through November 2021. In addition, we paid off our other note payable, secured by real estate, in June 2010 totaling \$0.1 million.

#### Item 4. Controls and Procedures.

We maintain disclosure controls and procedures that are designed to ensure the information we are required to disclose in the reports we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. Based on their evaluation as of June 30, 2010, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to accomplish their objectives and to ensure the information required to be disclosed in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During the period covered by this report on Form 10-Q, there have been no changes in our internal control over financial reporting that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## PART II OTHER INFORMATION

#### Item 6. Exhibits.

Exhibit No.	Description
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes Oxley Act of 2002.
31.2	Certification of Chief Financial Officer under Section 302 of the Sarbanes Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	

Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ADVANTAGE TECHNOLOGIES GROUP, INC.  
(Registrant)

/s/ Kenneth A. Chymiak  
Date: August 10, 2010  
President and Chief Executive Officer  
(Principal Executive Officer)

Kenneth A. Chymiak,

/s/ Scott A. Francis  
Date: August 10, 2010  
Chief Financial Officer  
(Principal Financial Officer)

Scott A. Francis,

Exhibit Index

The following documents are included as exhibits to this Form 10-Q:

Exhibit No.	Description
31.1	Certification of Chief Executive Officer under Section 302 of the Sarbanes Oxley Act of 2002.
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